FILE COPY

Office-Supreme Court, U.S.
FILED
JUL 21 1964
JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1964

No. ... 806

In The Matter
of
CHICAGO EXPRESS, INCORPORATED,
Debtor.

THE PENNSYLVANIA RAILROAD COMPANY,
Petitioner-Appellant,

CHICAGO EXPRESS, INCORPORATED,
Respondent-Appellee.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

EDWARD F. BUTLER,
Counsel for Petitioner,
20 Exchange Place,
New York, New York.

INDEX

	PAGE
Opinions Below	2
Jurisdiction	2
Question Presented	2
Statute Involved	2
Statement	2
Specifications of Errors to be Urged	4
Reasons for Granting the Writ	4
Conclusion	13
Appendix A—Statutes	14
B—Opinion Below	17
C—Judgment Below	23

CITATIONS

Cases:

Blair v. St. Louis H. & K. R. Co., 22 Fed. 471 (Cir. Ct., E. D. Mo. 1884)	5
Commonwealth of Pennsylvania v. Stocker, 70 F. 2d 453 (3rd Cir. 1934)	10
Farmers Loan & Trust Co. v. Kansas City W. & N. W. R. Co., 53 Fed. 182 (Cir. Ct., D. Kansas 1892)	5
Fosdick v. Schall, 99 U. S. 235 (1878)	3

PAGE

Miltenberger v. Logansport Railway, 106 U. S. 286 (1882) 5, 7

Missouri Motor Distributing Corporation, In re, 21 F. Supp. 13 (D. C., W. D. Mo. 1937) 5

New York Dock Company v. Poznan, 274 U. S. 117 (1927) 8

Paramount Merrick, Inc., In re, 252 F. 2d 482 (2nd Cir. 1958) 8

Pearlman v. Reliance Insurance Co., 371 U. S. 132 (1962) 7

Pepper v. Litton, 308 U. S. 295 (1939) 9

Pusey & Jones Corporation, In re, 192 F. Supp. 233 (D. Del. 1961), aff'd 295 F. 2d 479 (3rd Cir. 1961) 10

Southern Railway Company v. Flournoy, 301 F. 2d 847 (4th Cir. 1962) 5, 7

Southern Ry. v. U. S., 306 F. 2d 119 (5th Cir. 1962) .. 12

Van Frank v. Missouri Pacific Railway Co., 89 Mo. App. 460 (1901) 5

STATUTES

Bankruptcy Act, Sec. 64 (11 U. S. C. Sec. 104 ... 3, 4, 7, 8, 9, 10, 14

Judiciary and Judicial Procedure, 28 U. S. C. Sec. 1254 (1) 2

MISCELLANEOUS

Substituted Service—Charges and Practices of For-Hire Carriers and Freight Forwarders (Piggy-back Service), 322 I. C. C. 301 (March 16, 1964) 9, 11

IN THE

Supreme Court of the United States

OCTOBER TERM, 1964

No. .....

In The Matter

of

CHICAGO EXPRESS, INCORPORATED,

Debtor.

THE PENNSYLVANIA RAILROAD COMPANY,

Petitioner-Appellant,

CHICAGO EXPRESS, INCORPORATED,

Respondent-Appellee.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner

Appellant prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered in the above-entitled case on April 24, 1964.

Opinions Below

The memorandum opinion of the referee in bankruptcy (40a)* is unreported. The opinion of the District Court (65a) is reported in 222 F. Supp. 566. The opinion of the Circuit Court of Appeals (Appendix B, *infra*, pp. A2-A7) is reported in —— F. 2d ——.

Jurisdiction

The judgment of the Circuit Court of Appeals was entered on April 24, 1964 (Appendix C, *infra*, pp. A8-A9). The jurisdiction of this Court is invoked under 28 U.S.C., Sec. 1254(1).

Question Presented

Whether interline freight accounts owing to a rail carrier from a debtor motor common carrier, earned by furnishing "piggy-back" rail carriage to the debtor's trailers on joint motor-rail hauls, are entitled to a preference or priority in the latter's arrangement proceeding under Chapter XI of the Bankruptcy Act.

Statute Involved

The pertinent statutory provisions are printed in Appendix A, *infra*, page A1.

Statement

Chicago Express, Incorporated filed a petition for an arrangement on May 11, 1962 (8a). The Pennsylvania Railroad Company filed a proof of claim asking for a pref-

*References are to Appendix to Appellant's Brief in the United States Court of Appeals for the Second Circuit.

erence for interline freight accounts in the amount of $265,965.75, arising from "piggy-back" rail carriage of the debtor's trailers on joint motor-rail hauls made within six months of the debtor's initiation of bankruptcy proceedings (3a). By a petition to show cause dated November 26, 1962, the debtor in possession objected to the preferred status of the Pennsylvania's claim (8a). After a hearing, the Referee expunged the preferred status of the claim in an order dated December 17, 1962 (13a). Upon review, the District Court remanded the proceedings with instructions to vacate the order and to make formal findings of fact and conclusions of law indicating fully the relationship of the debtor and the Pennsylvania and the facts with respect to the Pennsylvania's trust fund theory (14a). The Referee subsequently vacated his previous order (15a) directed a re-hearing and took testimony (16a-39a). Thereafter the Referee made Findings of Fact and Conclusions of Law (50a-56a) resulting in an order once again expunging the preferred status of the Pennsylvania's claim (57a). Upon petition for review (59a), the District Court affirmed the Referee's order, holding that the "six months rule", recognizing a preference for short-term interline traffic and freight balances of connecting common carriers, enunciated in *Fosdick* v. *Schall*, 99 U. S. 235 (1878), was inapplicable in arrangement proceeding under Chapter XI of the Bankruptcy Act. The District Court also rejected the Pennsylvania's two alternate grounds for preferred status, viz.: 1. The six months rule being a "law of the United States" entitling the Pennsylvania to a priority over unsecured claimants under Section 64(a)(5) of the Bankruptcy Act; and 2. the revenue collected by the debtor on joint motor-rail shipments being trust funds to which the Pennsylvania was entitled under an agreement by the parties to apportion total charges on joint motor-rail hauls (65a-76a).

The Court below affirmed the order of the District Court. It rejected the Pennsylvania's claim for priority based on

the six months rule, holding that Section 64 of the Bankruptcy Act, applicable in Chapter XI proceedings, had eliminated the traditional power of a Bankruptcy Court to grant a preference to creditors who had contributed either to the preservation or creation of the fund in its custody. The Court accepted the District Court's reasoning in rejecting the Pennsylvania's trust fund theory, finding only a simple contract to pay a fixed charge, and also rejected the Pennsylvania's claim for a priority based on Section 64(a)(5), taking the position that the phrase "laws of the United States" therein referred only to statutory rather than decisional law (Appendix B, pp. A2-A7).

Specification of Errors to Be Urged

The Circuit Court of Appeals erred:

1. In failing to hold that the six months rule was applicable in a Chapter XI proceeding, entitling the Pennsylvania to a preference for its interline freight charges.

2. In failing to hold that the six months rule was a "law of the United States" entitling the Pennsylvania to a priority over unsecured claimants by virtue of Section 64(a)(5) of the Bankruptcy Act.

3. In failing to hold that the Pennsylvania's claim was entitled to a preference because the revenue collected by the debtor for the shipments involved was collected by it in trust for the Pennsylvania to the extent of the divisions to which the Pennsylvania became entitled.

4. In affirming the order of the District Court.

Reasons for Granting the Writ

1. The decision of the Court below in the instant case and its order denying the applicability of the six months rule to the interline freight charges owed by the debtor

to the Pennsylvania, are directly in conflict with the principles of preference and priority enunciated in decisions of this Court and followed by the Circuit Courts of Appeals for over eighty years in cases dealing with the treatment by bankruptcy tribunals of traffic and freight balances owed by one bankrupt connecting carrier to other connecting carriers.

This Court, in allowing first lien priority status for interline freight balances over the claims of secured creditors, declared in *Miltenberger* v. *Logansport Railway*, 106 U. S. 286, 312 (1882), that the payment of freight balances due connecting carriers "involving largely, also, the interests and accommodation of travel and traffic, may well place such payments in the category of payments to preserve the mortgaged property in a large sense, by maintaining the good will and integrity of the enterprise, and entitle them to be made a *first lien*" (emphasis added).

As recently as 1962, the Fourth Circuit reviewed the case law in this area and declared, in *Southern Railway Company* v. *Flournoy*, 301 F. 2d 847, 854 (4th Cir. 1962):

> "A. & D.'s history shows it could not possibly have posted advance payments or made 'junction settlements'. That other lines could then have refused traffic coming to and from A. & D. constitutes an immediate necessity of payment threatening the debtor. With the District Court we agree that interline accounts are an equitable lien on the railroad properties and outrank the mortgages."

In accord: *Van Frank* v. *Missouri Pacific Railway Co.*, 89 Mo. App. 460 (1901); *Farmers Loan & Trust Co.* v. *Kansas City W. & N. W. R. Co.*, 53 Fed. 182 (Circuit Court, D. Kansas 1892); *Blair* v. *St. Louis H. & K. R. Co.*, 22 Fed. 471 (Circuit Court E. D. Mo. 1884).

In *In re Missouri Motor Distributing Corporation*, 21 F. Supp. 13 (D. C., W. D. Mo. 1937), the court recognized the

priority of a claim by a motor carrier for freight charges collected by another motor carrier prior to its bankruptcy for through transit on a joint haul.

The court declared, at 21 F. Supp. 13:

> "Such arrangements were made between the claimants and the debtor in accordance with usual traffic customs and arrangements. This means that the initial carriers of freight or merchandise may collect all of the tariff or traffic charges and thereafter make division with the other carriers. . . . In the case of common carriers, the courts have indicated that priorities or preferences may be allowed for current expenses. While these are exceptions to the general rule, yet, nevertheless, they are allowed in case of common carriers because of the interest of the public. See Central Trust Co. v. Chicago A. & N. Ry. Co. (D. C.), 232 F. 936."

In the District Court decision in the instant case, the Court declared (70a):

> "Assuming that it is the public interest in the continued operation of a transportation system or a utility company, rather than a broader principle of equity, that constitutes the backbone of the rule, see *In re Pusey and Jones Corp.*, 192 F. Supp. 233, 235 (D. Del.), *aff'd*, 295 F. 2d 479 (3 Cir. 1961), it may not be readily apparent why a priority should be granted a claim against a common carrier by rail and denied a claim against a common carrier by motor vehicle. The Pennsylvania argues with some force that 'it is illogical to make the right to . . . [priority] dependent upon the road-bed utilized by the debtor carrier,' and cites one case recognizing the priority of a claim by a motor carrier for freight charges collected by another motor carrier for through transit on a joint haul, *In re Missouri Motor Distrib. Corp.*, 21 F. Supp. 13 (W. D. Mo. 1937)."

The District Court concluded, however, as did the Circuit Court thereafter, that the Pennsylvania's claim for a preference must be rejected on the ground that the six months rule was inapplicable in a Chapter XI proceeding. The District Court stated (71a):

> "Priorities in Chapter XI arrangements, however, are specifically enumerated in Section 64 of the Act. See 11 U.S.C. § 702. This Section neither expressly recognizes the 'six-months rule' nor constitutes a blanket authorization for the importation of general equitable doctrines."

The six months rule, however, cannot be characterized as a mere equitable counterpart of the priority provisions of Section 64. There is no priority listed in Section 64 which gives the holder first lien status over secured claimants—and that is the type of priority with which the six months rule is concerned.

Decisions such as *Miltenberger* v. *Logansport Railway Co.*, 106 U. S. 286 (1882), and *Southern Railway Company* v. *Flournoy*, 301 F. 2d 847 (4th Cir. 1962), declare that traffic and freight balances owed by one bankrupt connecting carrier to other connecting carriers are a lien on the bankrupt's properties and outrank the mortgages. Unless the plainly expressed words of these decisions be ignored, they provide ample justification for the Pennsylvania's demand for preference as a first lien claimant in the proceedings at bar.

Recently, this Court declared that Section 64 is wholly inapplicable in determining whether preferred status in distribution exists for a claimant whose charge is based upon the doctrine of equitable lien.

In *Pearlman* v. *Reliance Ins. Co.*, 371 U. S. 132 (1962), this Court affirmed a decision of the Second Circuit granting a preference to the surety of a government contractor which had been adjudicated a bankrupt. The surety had

contended it had an equitable lien giving rise to preferred status in a fund withheld by the government out of earnings due the contractor.

As in the case at bar, the Trustee in Bankruptcy of the contractor declared that the controversy was governed entirely by the provisions of Section 64, which gave no priority to the claims of a surety for reimbursement. In affirming the right of the surety to a preference, the Court declared, at 371 U. S. 136:

> "This Court has recently reaffirmed that such property rights existing before bankruptcy in persons other than the bankrupt must be recognized and respected in bankruptcy. Consequently our question is not who was entitled to priority in distributions under Section 64, but whether the surety had, as it claimed, ownership of, an equitable lien on, or a prior right to this fund before bankruptcy adjudication."

2. Clearly, the questions presented are of importance in the administration of the federal bankruptcy law. The federal courts have consistently adhered to the equitable principle that services beneficial to the fund brought into a bankruptcy court should be compensated out of the fund so benefited. See e.g., *In re Paramount Merrick, Inc.*, 252 F. 2d 482 (2 Cir. 1958).

This principle, a basis for the six months rule, is regarded by the Circuit Court of Appeals in the instant case as inapplicable in a Chapter XI proceeding, although this Court has inferred it is of general application, an "incident to the judicial administration of a fund", resting on "the self-imposed duty of the court, in the exercise of its accustomed jurisdiction, to require that expenses which have contributed either to the preservation or creation of the fund in its custody shall be paid before a general distribution among those entitled to receive it." *New York Dock Company* v. *Poznan*, 274 U. S. 117, 121 (1927).

Settlement of the question of the applicability of the six months rule to Chapter XI proceedings involving debtor motor carriers engaged in "piggy-back" service is plainly in the public interest, since the phenomenal growth of Trailer on Flatcar Service in the past five years has led to widespread joint-rate arrangements similar to that found in the case at bar, between rail and motor common carriers providing a through-route service for shippers.

The Interstate Commerce Commission, in *Substituted Service—Charges and Practice of For-Hire Carriers and Freight Forwarders (Piggyback Service)*, 322 I.C.C. 301, 307 (March 16, 1964), has declared:

> "There can be little doubt that piggybacking has been a decisive factor in returning to the railroads a substantial volume of traffic that previously had been moving by other modes of transportation, private and for-hire. The growth of plan I has meant a direct growth in railroad participation in motor common carrier highway traffic."

3. The decision of the Court below is believed to be erroneous in its construction of Section 64(a)(5) of the Bankruptcy Act, according priority to "debts owing to any person, including the United States, who by the laws of the United States, is entitled to priority . . ." The Pennsylvania's contention that the six months rule was a "law of the United States" within the meaning of Section 64(a)(5) was rejected by the Court below on the ground that "laws of the United States" meant statutes, not doctrines judicially evolved.

It is clear, however, that the policies of the Federal Bankruptcy Law are determined not only by statutes but by Federal courts applying "the principles and rules of equity jurisprudence". *Pepper* v. *Litton*, 308 U. S. 295, 304 (1939). The six months rule was developed because of the determination of Federal courts that there was "a

public interest in the continued operation of public and quasi-public corporations". *In re Pusey & Jones Corporation*, 192 F. Supp. 233, 235 (D. Del. 1961), aff'd 295 F. 2d 479 (3rd Cir. 1961). The decisions establishing a priority for short term claims for traffic and freight balances incurred by connecting carriers prior to insolvency proceedings have been followed by Federal courts for more than 80 years.

Section 64(a)(5) in its present form came into the Bankruptcy Act in 1938 upon the enactment of the Chandler Act. Prior thereto the subject matter had been covered in Section 64(b)(7) which granted a priority to "debts owing to any person who by the laws of the State or the United States is entitled to priority". In *Commonwealth of Pennsylvania* v. *Stocker*, 70 F. 2d 453 (3rd Cir. 1934), the Court applied the decisional law of Pennsylvania in determining that the sovereign was entitled to a priority pursuant to Section 64(b)(7).

Since the Federal bankruptcy courts have exclusive jurisdiction to determine preferences and priorities in all bankruptcy proceedings and since Federal courts have established the six months rule in this area, we submit that it is a "law of the United States" within the meaning of Section 64(a)(5).

4. The decision of the Court below is believed to be erroneous in its failure to hold that the revenue collected by the debtor for the shipments involved was collected by it as agent for the Pennsylvania to the extent of the divisions to which the Pennsylvania became entitled under an agreement by the parties to apportion total charges on joint motor-rail hauls. It is the Pennsylvania's contention that the funds thus received by the debtor were received by it in trust for the Pennsylvania and are consequently not a part of the debtor's estate.

The referee found otherwise, however, declaring, "There was nothing more than a simple contract to pay a fixed charge for the 'piggy back' services to be rendered by claimant, and this created nothing more than a simple debtor-creditor relationship" (49a).

The Pennsylvania's contention that the referee's finding was clearly erroneous in the light of the connecting carrier relationship of the carriers involved was rejected by both the District Court and the Circuit Court of Appeals (74a-76a) (Appendix B, p. A3).

Such a finding in the circumstances present in the case at bar, however, could only have been based upon the clearly erroneous assumption that the motor carrier's status in Plan I service was equivalent to that of a shipper to whom the railroad was furnishing a transportation service. The Interstate Commerce Commission has time and again rejected just such a contention.

In its most recent pronouncement, *Substituted Service—Charges and Practices of For-Hire Carriers and Freight Forwarders (Piggyback Service)*, 322 I.C.C. 301 (March 16, 1964), the Interstate Commerce Commission, reviewing Plan I service throughout the country, discussed the division agreements entered into by the rail and motor common carriers utilizing piggyback service and declared:

> "There are only two ways in which a rail carrier can provide for receiving compensation for its transportation services. It can through tariff publication establish charges, which must be just and reasonable, for a particular service to be rendered, or it can enter into joint-rate arrangements with other carriers and establish divisions, which must also be just and reasonable of the charge established jointly for the through service . . ." (322 I.C.C. at 327, 328)
>
> "Under a plan I arrangement, the motor carrier and railroad do, in fact, agree to transport, at a single

through rate, any given shipment of freight falling within the scope of their tariff publication, and no rates are charged or tariffs published with respect to such plan I operations on any other basis. The arrangement between the railroad and the motor carriers, under which the railroad is to be compensated for its portion of the through service, is thus a division agreement specifically authorized by section 216(c), and not a separate rate or charge." (322 I.C.C. at 345)

The testimony in the case at bar was clear and uncontradicted that the division sheet published by the Pennsylvania, which listed the charges representing its division of the revenue received by the debtor on joint hauls, was arrived at only after negotiation between all the carriers participating in the Plan I piggyback service (24a), an arrangement for sharing revenue no different in principle from that found in like arrangements for compensation entered into by connecting rail carriers in all-rail shipments from which, courts have traditionally held, fiduciary obligations arise. Cf. *Southern Ry.* v. *U. S.*, 306 F. 2d 119, 125 (5th Cir. 1962), wherein it was declared by the Fifth Circuit that where a debtor carrier has a duty to remit traffic balances following periodic settlements of the connecting carriers concerned, the funds which the debtor had rightfully collected from shippers and mingled acquire a "trust" character.

In the case at bar, the debtor's duty to remit to the Pennsylvania its share of the revenue collected on joint motor-rail hauls arose fifteen days after receipt by the railroad of the "truck-train waybill" submitted to the Pennsylvania by the debtor at the time of its tender of trailers (53a). At this time, all funds held by the debtor for remission to the Pennsylvania acquired a "trust character". Cf. *Southern Ry.* v. *U. S.*, 306 F. 2d 119, 125 (5 Cir. 1962).

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

EDWARD F. BUTLER,
Counsel for Petitioner.

MYRON D. COHEN,
Of Counsel.

APPENDIX A

Statutes

Bankruptcy Act: § 64, 11 U.S.C. § 104.

(a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the fees for the referee's salary and expense fund; the filing fees paid by creditors in involuntary cases or by persons other than the bankrupts in voluntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, is recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of the recovery; the trustee's expenses in opposing the bankrupt's discharge or in connection with the criminal prosecution of an offense punishable under chapter 9 of Title 18, or an offense concerning the business or property of the bankrupt punishable under other laws, Federal or State; the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the bankrupt in voluntary and involuntary cases, and to the petitioning creditors in involuntary cases, and if the court adjudges the debtor bankrupt over the debtor's objection or pursuant to a voluntary petition filed by the debtor during the pendency of an involuntary proceeding, for the reasonable costs and expenses incurred, or the reasonable disbursements made, by them, including but not limited to compensation of accountants and appraisers employed by them, in such amount as the court may allow. Where

an order is entered in a proceeding under any chapter of this title directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding shall have priority in advance of payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superseded proceeding and in the suspended bankruptcy proceeding, if any; (2) wages and commissions, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; and for the purposes of this clause, the term "traveling or city salesman" shall include all such salesmen, whether or not they are independent contractors selling the products or services of the bankrupt on a commission basis, with or without a drawing account or formal contract; (3) where the confirmation of an arrangement or wage-earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under chapter 9 of Title 18, the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof; *Provided*, That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court; *And provided further*, That, in case any question arises as to the amount or legality of any taxes,

such question shall be heard and determined by the court; and (5) debts owing to any person, including the United States, who by the laws of the United States is entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law; *provided, however,* That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy.

APPENDIX B

Opinion

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 371—September Term, 1963.

(Argued March 18, 1964 Decided April 24, 1964.)

Docket No. 28613

In the Matter

of

CHICAGO EXPRESS, INCORPORATED,

Bankrupt.

THE PENNSYLVANIA RAILROAD COMPANY,

Petitioner-Appellant,

v.

CHICAGO EXPRESS, INCORPORATED,

Respondent-Appellee.

Before:

LUMBARD, *Chief Judge,*
FRIENDLY and HAYS, *Circuit Judges.*

Appeal by The Pennsylvania Railroad Company from an order of the District Court for the Southern District of New York, Wilfred Feinberg, *Judge,* 222 F. Supp. 566 (1963), rejecting its claim for priority for interline traffic

balances in a proceeding of a motor carrier under Chapter XI of the Bankruptcy Act. Affirmed.

MYRON D. COHEN (Conboy, Hewitt, O'Brien & Boardman, New York, N. Y.; Edward F. Butler, of Counsel), *for Petitioner-Appellant.*

SIDNEY KRAUSE (Krause, Hirsch, Gross & Heilpern, New York, N. Y.; Myron Kove, of Counsel), *for Respondent-Appellee.*

FRIENDLY, *Circuit Judge*:

The Pennsylvania Railroad Company appeals from a decision of Judge Feinberg, in the District Court for the Southern District of New York, 222 F. Supp. 566 (1963), rejecting its claim that interline freight charges owing to it from the debtor, Chicago Express, a motor carrier, earned by furnishing "piggy-back" rail carriage to the debtor's trailers, were entitled to priority in the latter's arrangement proceeding under Chapter XI of the Bankruptcy Act. The Pennsylvania rested its claim to priority on the alternative theories that its share of amounts collected by the motor carrier from shippers constituted trust funds, and that since the traffic balances accrued between March 1, 1962 and the filing of the petition on May 11, 1962, they deserved priority under the so-called "six months rule" enunciated in *Fosdick* v. *Schall*, 99 U. S. 235 (1879).

As to the trust fund theory, we have nothing to add to Judge Feinberg's excellent discussion, 222 F. Supp. at 572. Although we accept the Pennsylvania's position that Chicago Express was a connecting carrier with the Penn-

sylvania and not a shipper over it, this, without more, did not create a duty on the part of Chicago Express to hold amounts due to the Pennsylvania in trust or make the relationship other than that of debtor and creditor.

As to the claim for priority based on the six-months rule we think it unnecessary to determine whether and, if so, under what circumstances and to what extent that rule might apply to a motor carrier in an equity receivership or a proceeding for reorganization under Chapter X of the Bankruptcy Act. For the rule can have no application in a proceeding under Chapter XI.

To begin with, despite some statements that claims protected by the six-months rule constitute "equitable liens," *Larsen* v. *New York Dock Co.*, 166 F. 2d 687, 689 (2 Cir. 1948); *Southern Ry.* v. *Flournoy*, 301 F. 2d 847, 854 (4 Cir. 1962), it was made clear in *New York Dock Co.* v. *S.S. Poznan*, 274 U. S. 117, 121 (1927), that the preferences given such claims by courts of equity were "not to be explained in terms of equitable liens in the technical sense, as is the case with agreements that particular property shall be applied as security for the satisfaction of particular obligations or vendors' liens and the like . . ." but "result rather from the self-imposed duty of the court . . . to require that expenses which have contributed either to the preservation or creation of the fund in its custody shall be paid before a general distribution among those entitled to receive it", even, in appropriate instances, out of the earnings or proceeds of mortgaged property. See the discussion in Cutcheon, Recent Developments in Federal Railroad Foreclosure Procedure, Ass'n of the Bar of the City of New York, Some Legal Phases of Corporate Financing, Reorganization and Regulation, 1926-30, pp. 105-110.

Priorities under the Bankruptcy Act are a creature of statute. 3 Collier, bankruptcy, 2061 (1961 ed.). Congress has enacted different provisions with respect to priorities

for the various types of proceedings authorized by the Act. For ordinary bankruptcy the controlling provision is § 64. In § 77, relating to railroad reorganizations, subdivision (b) provides that "unsecured claims, which would have been entitled to priority if a receiver in equity of the property of the debtor had been appointed by a Federal court on the day of the approval of the petition, shall be entitled to such priority and the holders of such claims shall be treated as a separate class or classes of creditors"; plainly this includes the rule of *Fosdick* v. *Schall*. See 5 Collier, Bankruptcy, ¶77.21 (1962). In Chapter X, relating to corporate reorganizations, Congress in § 102 ruled out the application of § 64, and provided in § 115 that the court "shall have and may, in addition to the jurisdiction, powers, and duties hereinabove and elsewhere in this chapter conferred and imposed upon it, exercise all the powers, not inconsistent with the provisions of this chapter, which a court of the United States would have if it had appointed a receiver in equity of the property of the debtor on the ground of insolvency or inability to meet its debts as they mature."[1] In contrast, § 302 subjects priority questions in Chapter XI proceedings to the rules stated in § 64.

The Pennsylvania may therefore prevail only if it can bring its claim within one of the classes enumerated by that section.[2] The only one contended to be pertinent is § 64(a)

---

[1] The predecessor of Chapter X, § 77B of the Bankruptcy Act, was considerably more specific with respect to priorities; it provided, in subdivision (b)(10), priority for "unsecured claims which would have been entitled to priority over existing mortgages if a receiver in equity of the property of the debtor had been appointed by a Federal court on the day of the approval of the petition or answer under this section . . ." 48 Stat. 915 (1934). This substantially followed the language of § 77(c) as originally enacted. 47 Stat. 1477 (1933).

[2] See *In the Matter of Pusey and Jones Corp.*, 295 F. 2d 479 (3 Cir. 1961).

(5) according priority to "debts owing to any person, including the United States, who by the laws of the United States is entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law . . ." subject to a limitation as to the latter therein provided; it is contended that the equitable doctrine of *Fosdick* v. *Schall* is a "law of the United States" within that provision. The issue, although reminiscent of the great debates over the meaning of "The laws of the several States" in § 34 of the Judiciary Act of 1789, 1 Stat. 92, see *Swift* v. *Tyson*, 41 U. S. (16 Pet.) 1 (1842); *Erie R.R.* v. *Tompkins*, 304 U. S. 64 (1938); and of "the laws of the United States" in the Act of March 3, 1875, 18 Stat. 470, see *Romero* v. *International Terminal Operating Co.*, 358 U. S. 354 (1959), is much more readily resolved. As the section stood in the Bankruptcy Act of 1898, 30 Stat. 563, it referred to "debts owing to any person who by the laws of the States or the United States is entitled to priority." It seems altogether plain that under the philosophy of *Swift* v. *Tyson* then prevailing, Congress thought that "laws" meant statutes, not doctrines judicially evolved. Had the reference to the "laws" of the United States been intended to import the six-months rule for certain industries into § 64, this would have created a strange and unexplained conflict with the general three-month priority for wages, limited to three hundred dollars per claimant, which was established by § 64(b)(4), now § 64(a)(2). Furthermore, railroad corporations, the prime instance of application of the "six-months rule," have been wholly excluded from the general provisions of the Bankruptcy Act since 1910, 36 Stat. 839, and they cannot invoke Chapter XI, § 306(3). If additional support for a construction excluding federal decisional law from § 64(a)(5) were needed, this might be found in the contrast drawn under the 1938 amendment, 52 Stat. 874, which, generally deleting priorities under "the laws of the

States", continued to give priority to "debts owing to any person, including the United States, who by the *laws* of the United States is entitled to priority," and for "rent owing to a landlord who is entitled to priority under applicable State *law*"; to twentieth century ears, the singular, "law," is more apt to include judge-made law than the plural. However, in view of the lack of authoritative construction of the last quoted phrase, see 3 Collier, Bankruptcy, 2238 fn. 14, we think it best to leave that issue open.

Affirmed.

APPENDIX C

Judgment

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York on the twenty-fourth day of April, one thousand nine hundred and sixty-four.

Present:

HON. J. EDWARD LUMBARD,
Chief Judge.
HON. HENRY J. FRIENDLY,
HON. PAUL R. HAYS,
Circuit Judges.

(SEAL)

IN THE MATTER

of

CHICAGO EXPRESS, INCORPORATED,

Debtor,

vs.

THE PENNSYLVANIA RAILROAD COMPANY,

Appellant.

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript on record from the United States District Court for the Southern District of New York and was argued by counsel.

Appendix C.

On Consideration Whereof it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is affirmed; with costs to the appellee.

A. Daniel Fusaro,
Clerk.

A true copy,

A. Daniel Fusaro,

Clerk.

Docketed as a Judgment #66,688

On June 5, 1964

At 11:55 A.M.

Appendix C.

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

BILL OF COSTS

No. 371

September Term, 1963

Taxed in favor of Appellee, in

IN THE MATTER

of

CHICAGO EXPRESS, INCORPORATED,

Debtor,

vs.

THE PENNSYLVANIA RAILROAD COMPANY,

Appellant.

Cost of Printing Appendix $206.96

Taxed at the sum of $206.96

(SEAL)

A. DANIEL FUSARO,
Clerk.

A true copy,
A. DANIEL FUSARO,
Clerk.

DOCKETED AS A JUDGMENT #66,688
ON June 5, 1964
AT 11:55 A.M.

ILE COPY

No. 306

Office-Supreme Court, U.S.
FILED
SEP 14 1964
JOHN F. DAVIS, CLERK

Supreme Court of the United States

OCTOBER TERM, 1964.

IN THE MATTER

of

CHICAGO EXPRESS, INCORPORATED,

Debtor.

THE PENNSYLVANIA RAILROAD COMPANY,

Petitioner-Appellant,

CHICAGO EXPRESS, INCORPORATED,

Respondent-Appellee.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

SYDNEY KRAUSE,
Counsel for Respondent-Appellee,
521 Fifth Avenue,
New York, N. Y. 10017

Supreme Court of the United States

OCTOBER TERM, 1964.

IN THE MATTER

of

CHICAGO EXPRESS, INCORPORATED,

Debtor.

THE PENNSYLVANIA RAILROAD COMPANY,

Petitioner-Appellant,

CHICAGO EXPRESS, INCORPORATED,

Respondent-Appellee.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

Respondent-Appellee.

Respondent-Appellee respectfully submits that the petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit, entered in the above-entitled case on April 24, 1964, should be denied.

Question Presented.

Whether a claim for priority based upon the so-called "six-month rule" can be allowed in a proceeding under Chapter XI (Arrangements) of the Bankruptcy Act.

Statutes Involved.

Sec. 64a. This statute is set forth at length in Appendix A (p. 14) of the petition for the writ.

Sec. 302. "The provisions of chapters I to VII, inclusive, of this Act shall, insofar as they are not inconsistent with or in conflict with the provisions of this chapter, apply in proceedings under this chapter. . . ."

Sec. 102. "The provisions of chapters I to VII, inclusive, of this Act shall, insofar as they are not inconsistent or in conflict with the provisions of this chapter, apply in proceedings under this chapter: *Provided, however,* That . . . section 64 . . . shall not apply in such proceedings unless an order shall be entered directing that bankruptcy be proceeded with pursuant to the provisions of chapters I to VII, inclusive. . . ."

Statement.

Chicago Express, Incorporated, Respondent-Appellee, and sometimes referred to herein as the Debtor, filed a petition for Arrangement under Section 322 of the Bankruptcy Act on May 11, 1962. The Debtor was engaged in the interstate trucking business under franchises approved by the Interstate Commerce Commission.

The Pennsylvania Railroad Company (Petitioner-Appellant) and sometimes referred to herein as Pennsylvania, filed a proof of claim seeking a preference for an unpaid debt in the amount of $265,965.75. The consideration for this debt was the furnishing by Pennsylvania of service to the Debtor, prior to the filing of the Arrangement, consisting of "piggy-back" rail carriage of the Debtor's trailers on joint motor hauls.

The Debtor objected to Pennsylvania's claim insofar as it requested priority (8a*). The claim for priority was denied successively by the Referee in Bankruptcy (40a-58a); the District Court (65a-76a) and the Court of Appeals (Appendix B, pp. 17-22 of petition for writ).

Pennsylvania now seeks a writ of certiorari to review the decision and order of the Second Circuit.

Argument.

The decision of the lower court was unanimous. It affirmed the decision reached by the District Court, whose opinion thoroughly considered the authorities, and, in a meticulous and thorough review of the applicable authorities, rejected Pennsylvania's contention that the "six-months rule" was applicable in a Chapter XI proceeding (65a-76a). The District Court, in turn, had affirmed the decision of the Referee in Bankruptcy before whom this matter came in the first instance (40a-49a).

No court by which Pennsylvania's claim for priority has been decided has had any reservations as to the applicability of the priority hierarchy set forth in 64a of the Bankruptcy Act.

The problem, generally, is not one of a frequently recurring nature nor of overriding importance. No valid reason has been adduced to justify further review of the result that has been reached. The decision below is not in conflict with any decision of any other Circuit of the United States Court of Appeals.

The "six-month rule" was formulated by this Honorable Court in a railroad reorganization case.

Fosdick v. *Schall*, 99 U. S. 235 (1879).

---

* All page references, unless otherwise indicated, will refer to the appendix of Appellant's brief in the United States Court of Appeals.

In effect, it permitted a preferred or priority status to unsecured creditors whose claims were incurred as operating expenses within six months of the institution of a railroad reorganization proceeding.

The doctrine, although initially confined to railroad reorganization cases, was, by decisions of lower federal courts, extended to claims against public and quasi-public service corporations.

> *Keelyn* v. *Carolina Mut. Tel. & Tel. Co.*, 90 Fed. 29 (C. C. D. S. C., 1898) (telephone and telegraph company);
>
> *Central Trust Co.* v. *Clark*, 81 Fed. 269 (8 Cir., 1897) (street railway);
>
> *Atlantic Trust Co.* v. *Woodbridge Canal & Irrigation Co.*, 79 Fed. 39 (C. C. N. D. Cal., 1897) (irrigation company);
>
> See FitzGibbon, *The Present Status of the Six Months' Rule*, 34 Colum. L. Rev. 230, 233 n. 8 (1934).

In one instance, the Court of Appeals for the Second Circuit applied the six months rule to a hotel that was undergoing reorganization under Chapter X of the Bankruptcy Act. The Court predicated the extension of the doctrine in that case on the ground that the continued operation of such an enterprise depended upon good will, the preservation of which was necessary to maintain the value of the lienholders' security.

> *Dudley* v. *Mealey*, 147 F. 2d 268, 271 (2 Cir.) *cert. denied* 325 U. S. 873 (1945).

Subsequently, however, the same Court of Appeals declared that the "rule should be strictly contained within

narrow confines and limited to the purposes which brought it into being," because it was an "invasion of the established contract rights of lienholders".

Johnson Fare Box Co. v. *Doyle,* 250 F. 2d 656, 657 (2 Cir.) *cert. denied* 357 U. S. 938 (1958).

Irrespective of the origin or rationale of the rule, the question of its application in a Chapter XI proceeding has posed no problem for any of the courts which have dealt with it.

In large measure, this unanimity of result has stemmed from the clarity of the statutory mandate. As the Court of Appeals pointed out in its decision (Appendix B, p. 20, of petition for writ) below, Section 77 relating to railroad reorganizations in subdivision (b) thereof provided that "unsecured claims, which would have been entitled to priority if a receiver in equity of the property of the debtor had been appointed by a Federal court on the day of the approval of the petition, shall be entitled to such priority and the holders of such claims shall be treated as a separate class or classes of creditors; . . ." The Court indicated that this clearly included the rule of *Fosdick* v. *Schall, supra.*

Section 102 of Chapter X of the Bankruptcy Act, the Corporate Reorganization chapter, uses language that expressly excludes the application of the priority section (64a) of Chapters I-VII of the Bankruptcy Act.

In contradistinction to the provisions of Section 102, Section 302 of Chapter XI, the Arrangement chapter, incorporates all of the provisions of Chapters I-VII of the Act, except insofar as they may be inconsistent with or in conflict with the provisions of Chapter XI. No such inconsistency or conflict can possibly be demonstrated in the instant case and Section 64 is applicable.

This leaves open only the matter of the propriety of the lower court's decision that section 64a(5) does not afford to Pennsylvania the priority which it seeks. Section 64a(5) provides for priority to

> "(5) debts owing to any person, including the United States, who by the laws of the United States in [sic.] entitled to priority . . ."

Pennsylvania argued that the equitable doctrine of *Fosdick* v. *Schall, supra*, is a law of the United States, thereby entitling its claim to priority under Section 64a(5).

The Court of Appeals has effectively disposed of this argument (Appendix B, p. 21, petitioner's writ) and held that "laws" means "statutes, not doctrines judicially evolved."

We respectfully submit that no convincing reason has been adduced to justify further review by this Honorable Court of the result which has consistently been reached by all of the Courts which have decided this matter.

Conclusion.

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

SYDNEY KRAUSE,
Counsel for Respondent-Appellee.

SYDNEY KRAUSE,
STEPHEN LOWEY,
Of Counsel.